MARKET REPORT

OFFICE

East Bay/Oakland Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

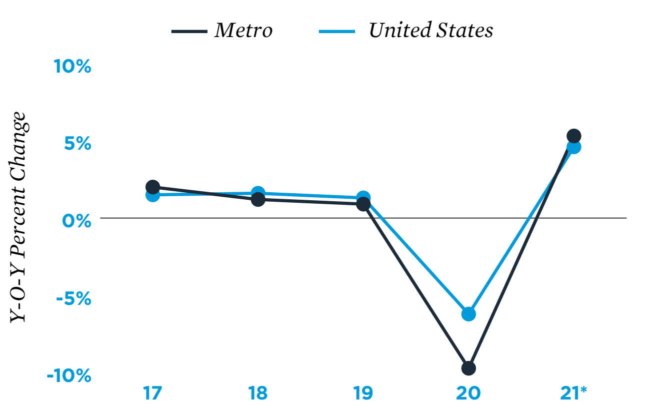
2Q/21

Class B/C Space Poised to Weather Downturn as Class A Assets Compete With Other Bay Area Metros

East Bay economy gains some traction. Relative to San Francisco and San Jose, the market's diverse payrolls have traditionally been a net benefit in recessions. During this downturn, however, the ability of office personnel to work remotely has supported payrolls in the other Bay Area markets. The result will be a longer road back to pre-health crisis employment performance. Some benefits are expected to arise from the recession. Remote and flex work will assuage concerns over long commutes, while lower housing costs attract high-paid tech employees no longer leashed to offices on the other side of the bay. The completion of the BART line into San Jose should also open up access to those workers. Overall, the distribution of wealth into the East Bay will generate population-service office jobs.

Bifurcation among office class performance. In the years ahead of the health crisis, Oakland served as a spillover market for tech companies fleeing the rapidly rising cost of office space in San Francisco and the South Bay. Average Class A asking rents were 70 percent of those on the other side of the Bay Bridge prior to the pandemic. A surge in available inventory in those markets will reduce spillover demand from companies searching for low-cost top-tier space. In the Class B/C sector, however, demand from office-using firms outside of tech will temper the amount of negative net absorption and could catalyze the office recovery as firms evaluate space needs.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

57,000 JOBS *will be created*

EMPLOYMENT:

After a 9.7 percent decline in employment last year, employers are expected to raise payrolls by 5.3 percent in 2021. Jobs in sectors that have traditionally occupied office space are projected to rise 3.5 percent.

37,000 SQ. FT. *will be completed*

CONSTRUCTION:

Most of the projects currently under construction are scheduled for delivery in the first half of 2022. Inventory is only anticipated to rise nominally this year, keeping supply-side pressure muted.

80 BASIS POINT *increase in vacancy*

VACANCY:

Vacancy should begin to stabilize in the second half of 2021, leaving the year-end rate at 15.1 percent. Last year, the rate jumped 210 basis points as 1.7 million square feet of office space was returned to the market.

3.7% DECREASE *in asking rent*

RENT:

Prior to the health crisis, average rent growth had already begun to diminish. In an effort to stem the tide of negative absorption, operators are expected to lower asking rents, dropping the average rate to $37.65 per square foot.

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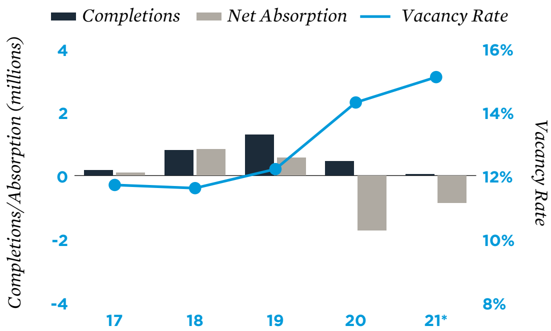
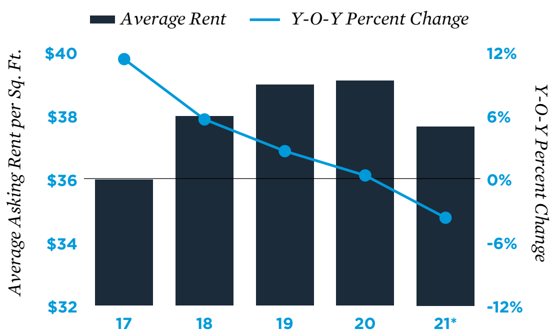
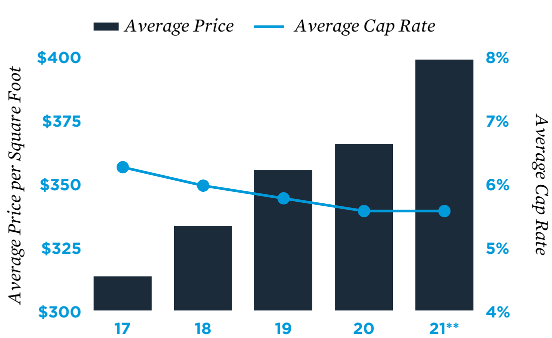
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 1Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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1Q21 — 12-Month Period

CONSTRUCTION

381,000 square feet completed

- Builders expanded inventory by 0.4 percent during the 12-month period ending in the first quarter.
- Approximately 250,000 square feet of space is currently under construction, though the most of that supply is not anticipated to be completed until 2022.

VACANCY

290 basis point increase in vacancy Y-O-Y

- Since April of 2020, office users have returned 2.6 million square feet to the market, lifting vacancy to 15.3 percent, the highest rate since the end of 2013.
- At 23.0 percent, Class A vacancy is 510 basis points higher than a year ago, while the Class B/C rate climbed 200 basis points to 12.3 percent.

RENT

1.7% decrease in the average asking rent Y-O-Y

- Rising availability put downward pressure on the average asking rent, which fell to $38.96 per square foot in the first quarter.
- Top-tier asking rent is down 1.4 percent year over year to $48.25 per square foot. In the Class B/C space, the average asking rent slipped 1.9 percent annually to $35.27 per square foot.

Investment Highlights

- Deal flow declined 65 percent last year as uncertainty surrounding the entire Bay Area office market encouraged most investors to pause. Furthermore, East Bay office properties were among those most likely to face significant distress due to the pandemic, though those fears have largely been assuaged in recent months. Thus far in 2021, transaction velocity is on pace to eclipse the 2020 level but fall short of the recent high watermark in 2019.
- In the 12-month period ending in the first quarter, the average price per square foot increased 11 percent to $399. The rise in price can be attributed to a flight to safety by investors that remained active in the market during the health crisis.
- The average cap rate contracted 10 basis points to 5.6 percent year over year. As the long-term outlook has become slightly more clear since the beginning of the year, buyers are expanding their search criteria, pushing up the average cap rate modestly.